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Before the
POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001

Institutional Cost Contribution	:	
Requirement for Competitive Products	:	Docket No. RM2017-1

INITIAL COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these comments pursuant to Order No. 3624 (November 22, 2016). GCA comprises about 200 greeting card publishers and related enterprises, and is the only postal trade association representing the interests of the citizen mailer. In this third inquiry into the appropriate share of total institutional costs to be covered by the contribution of competitive products, GCA recommends that the current 5.5 percent level, established in 2007, be increased.

I. THE STATUTORY SETTING AND THE HISTORY OF THE COMPETITIVE SHARE

Under 39 U.S.C. 3633(b), the Commission has broad discretion in determining the appropriate level of contribution from the competitive sector:

> . . . the Commission shall conduct a review to determine whether the institutional costs contribution requirement under subsection (a)(3) should be retained in its current form, modified, or eliminated. In making its determination, the Commission shall consider all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products.

Sec. 3633(a) comprises three distinct mandates, all enacted together in Pub. L. 109-435, for the single purpose of setting ground rules – through Commission rulemaking – for competitive product prices: a prohibition against cross-subsidization of competitive by market-dominant products (sec. 3633(a)(1)), a requirement that no competitive product fail to cover its attributable cost (sec. 3633(a)(2), and the appropriate share provision just quoted.

In the two previous determinations of the appropriate share, the Commission has used a variety of tests, all qualifying as “relevant” within the meaning of sec. 3633(b). We first review those determinations to see (i) how far the tests used in the past are still suitable, and (ii) if any “relevant circumstances” noted in those proceedings should be given additional prominence now.

The 2007 determination. In Order No. 26 the Commission proposed a competitive share level of 5.5 percent of total contribution, and confirmed this choice in Order No. 43.[1] The analysis began with the level of contribution – 6.9 percent – achieved under the then-current Docket R2006-1 rates. The Commission reduced this figure, citing three reasons: (i) the new and untested character of the regulatory system mandated by the Postal Accountability and Enhancement Act of 2006 (PAEA), (ii) the fact that under PAEA competitive rates were no longer to be set using the pricing factors of the 1970 Act, and (iii) that the Postal Service, being newly allowed to accumulate retained earnings, would have an incentive to price competitive profits with an eye to doing so. The operative explanation is in Order No. 26, beginning at ¶ 3050.

The first issue was the functional form of the share calculation. The Commission pointed out that a simple percentage of total institutional costs was preferable, since it both was simple, and did not imply the choice of a markup or the use of pricing factors – a disadvantage present in all the alternative forms suggested by commenters. Nothing that has occurred since 2007 suggests that this choice needs to be reconsidered.

There is good reason, however, to drop one of the three reasons the Commission gave for reducing the then-current contribution level from 6.9 to 5.5 percent. It is still true that competitive product pricing does not employ the pricing factors (now incorporated in sec. 3622(c)), and the incentive to generate retained earnings – while now perhaps present as an incentive simply to generate enough revenue to pay the bills – is still present. It is not the case, however, that the PAEA ratemaking system for competi-

[1] These orders were issued in Docket No. RM2007-1, on August 15 and October 29, 2007, respectively.

tive products is new and untried (cf. Order No. 26, ¶ 3060). To whatever extent this circumstance led the Commission to lower the share level in 2007, it should carry no weight now.

The 2011 determination. In Docket RM2012-3, the Commission started with the "statutorily required" circumstances. The first was "prevailing conditions in the market," an inquiry which the Commission decomposed into (i) any competitive advantage enjoyed by the Postal Service, (ii) changes in the Service's market share, and (iii) change in the market and the Service's competitors.

As to the first, the Commission found that (i) the Federal Trade Commission report found the Service at a net competitive *disadvantage,* (ii) there was no evidence (nor even allegations) of predatory pricing or other signs of undue competitive advantage, and (iii) since the achieved contribution had exceeded 5.5 percent, competitors enjoyed "another level of protection." As to the second, it also found that the demonstrated minor increase in market share did not suggest any undue advantage. Finally, the Commission identified two significant changes in the market: a projected expansion of the package market, and the departure of DHL from the domestic market. However, since the Service had continued to price at levels more than sufficient to produce a 5.5 percent contribution share, it did not find that they would provide an unfair advantage for it, or require a change in the share level.

The Commission then examined the contribution achieved over the five years since the 2007 review. Noting that it had increased in all cases but one, it concluded that the 5.5 percent requirement "[had] not hampered the Postal Service in pricing its competitive products."[2]

There had also been significant expansions of the competitive sector, through the transfer to it of commercial First-Class and Standard parcels. The Commission pointed out that institutional costs, by definition, are not associated with specific products, so

[2] Order No. 1449, p. 21.

that expansion of competitive volume is “not by itself related to the appropriate share requirement.”[3] It cautioned, however, that “under the right circumstances” (which it did not specify) a substantial increase in competitive volumes compared with market dominant could motivate reconsideration of the appropriate share.

The end result was a decision to keep the share at the 2007 level of 5.5 percent. All of the tests described above could be useful, in varying degrees, in the present review.

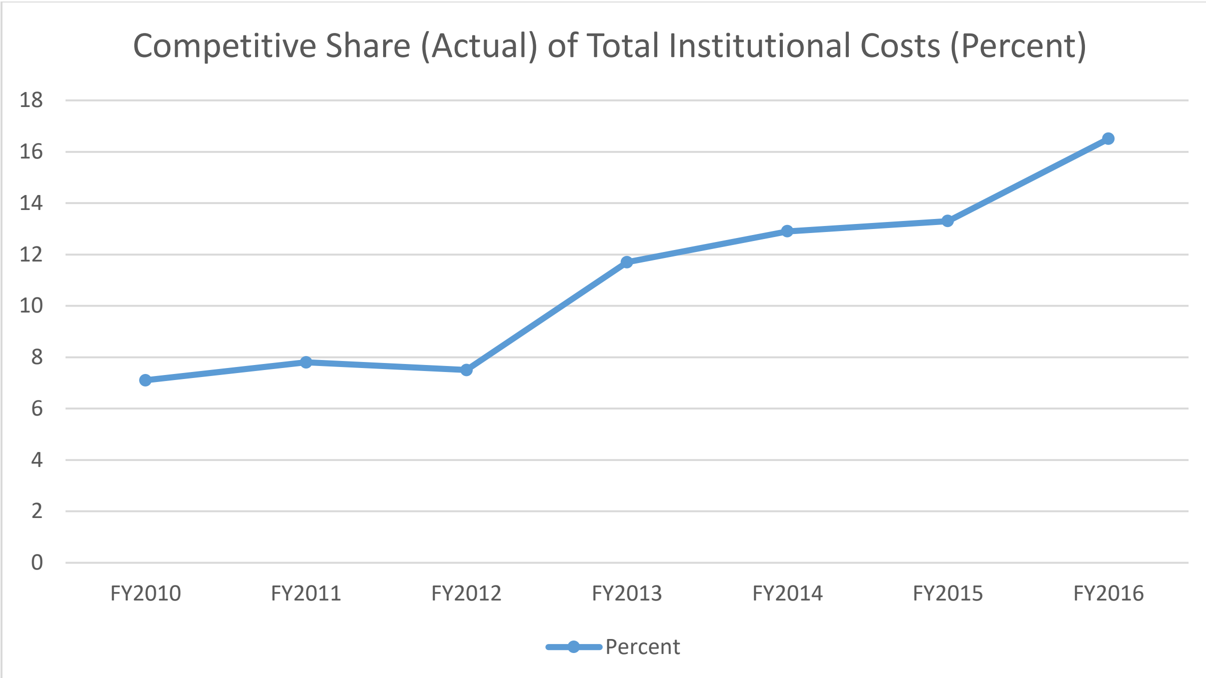
II. THE CONTRIBUTION SHARE SHOULD BE INCREASED CONSERVATIVELY

We begin by analyzing a variable which the Commission has used in both previous determinations: the contribution level actually achieved. In Docket RM2007-1, the historical data were simply those resulting from the R2006-1 rates, and the Commission reduced that achieved level for several reasons, one of which (the newness of the PAEA ratemaking scheme) is no longer operative. In Docket RM2012-3, the Commission relied on the trend in contribution level, which was predominantly upward.

The trend since FY 2010. This last consideration is particularly compelling in this Docket. The graph below[4] displays the trend in competitive share since FY 2010:

[3] Id., pp. 22-23.

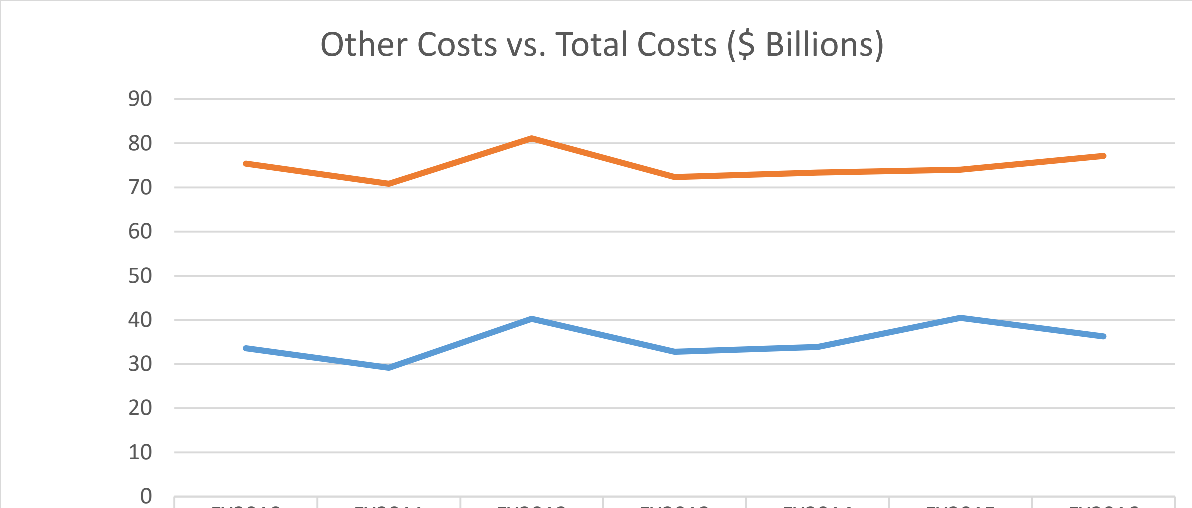
[4] In presenting these data, we have used the pre-Order 3506 approach in which volume variable plus specific fixed costs make up the attributable category. Our charts are thus consistent both internally over time and with the Postal Service’s presentations in its FY 2016 Annual Compliance Report. The values shown are taken from Annual Compliance Determination Reports and, in the case of FY 2016, the Postal Service’s Annual Compliance Report, pp. 89-90.



In FY 2015, the achieved contribution share was 2.4 times the 5.5-percent minimum, and in FY 2016, three times.

In 2012, an increase in achieved contribution from 5.66 percent to 7.82 percent (1:1.38) indicated that the minimum had not hampered the Service in its competitive product pricing. Evidently then, the substantially greater increase between FY 2010 and FY 2015 leads to the same conclusion.

Rejecting a potential counter-argument. It might be objected that an increase in achieved contribution could be caused, not by increasing profitability on the part of competitive products, but by an *overall* decline in the ratio of institutional cost to total cost. If this proportion were to fall, the argument would run, then a dollar of competitive product contribution would represent a larger fraction of total institutional cost and thus present the appearance of increasing profitability in the competitive sector. This argument can be checked by examining the ratio of institutional ("Other") to total cost over the relevant period. Data from the Postal Service's *Public Cost Segments and Components* reports shows that it has been essentially steady, save for an isolated increase in FY 2015:



	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
Other	33.564	29.153	40.212	32.769	33.832	40.438	36.25
Total	75.382	70.806	81.153	72.319	73.362	74.011	77.121

Ways of computing an appropriate competitive share. GCA suggests, accordingly, that the Commission establish a higher floor for competitive products' contribution. Because the market in which these products are sold is competitive, we recognize the need for a degree of conservatism in doing so. One suitable approach, continuing the Commission's previous historically-based approach, would be to average the competitive contribution percentages attained in recent years. Using the same span of time displayed in the first graph, above, we find:

FISCAL YEAR	COMPETITIVE SHARE (%)
2010	7.1
2011	7.8
2012	7.5
2013	11.7
2014	12.9
2015	13.3
2016	16.5
Average	10.97

We therefore suggest that the Commission set a competitive contribution share of between 10.5 and 11.0 percent. This approach gives equal weight to the earlier years in which the trend was essentially flat, and thus has a built-in element of conservatism.

As a check on it, however, we essentially replicated the Commission's procedure in Docket RM2007-1. Taking the most recent achieved level, we applied to it the proportion between the then most recent (R2006-1) level of 6.9 percent and the Commission's chosen floor of 5.5 percent. We applied this proportion – 1.2545 : 1.0 – to the most recent (FY 2016) figure shown above. The result (16.5 percent / 1.2545 = 13.15 percent) is even higher than that generated by our first approach, although the calculation still includes a downward adjustment providing an element of conservatism.

III. CONCLUSION

For the reasons stated above, GCA recommends that the Commission raise the minimum share of contribution required from competitive products at a more appropriate, though still conservative, level of between 10.5 and 11 percent.

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Respectfully submitted,

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